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OCT 14 1991

Dear Sir or Madam:

Your application for exemption from Federal income tax as an organization described in section 501(c)(3) of the Internal Revenue Code has been given consideration.

The information submitted shows that you were incorporated on [REDACTED] as a non-profit organization promoting the arts. Your activities encompass three general areas: (1) You provide a gallery where an artist's works are exhibited and sold. (2) You provide a workshop area where artists produce their works, and (3) you provide a place where artists, poets and musicians interact with the general public.

Your income is derived from a percentage of sales from artist's works and from grants and contributions from the general public. Your expenses include a percentage of sales paid back to artists and the costs of supplies, equipment maintenance and overhead. Your application and accompanying documents indicate that variously [REDACTED] to [REDACTED] of each sale of an artist's creation is retained by your organization and [REDACTED] to [REDACTED] is returned to the artist.

To promote the sale of artist's works you provide facilities and work space for participating artists, you provide an exhibition area that includes sales facilities, and you advertise for public patronage. Your services to artists include marketing and public relations assistance, and your advertisements include newspaper ads and articles, use of mailing lists and radio and TV announcements and shows.

Section 501(c)(3) of the Internal Revenue Code provides, in part, for the exemption from Federal income tax for organizations organized and operated exclusively for charitable and educational purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(c)(1) of the Income Tax Regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in sec-

tion 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(c)(2) of the Regulations provides in part that an organization is not operated exclusively for one or more exempt purposes if its earnings inure in whole or in part to the benefit of private shareholders or individuals.

The term "charitable" is used in section 501(c)(3) of the Code in its generally accepted legal sense and includes, among other purposes, the advancement of education. An "educational" purpose within the meaning of section 501(c)(3) includes instruction of the public on subjects useful to the individual and beneficial to the community. (See section 1.501(c)(3)-1(d)(2) and (3) of the Regulations.)

It is the long-standing position of the Service that cultural organizations devoted to the promotion of the arts may qualify for recognition of exemption as being educational or charitable in character. (See Rev. Rul. 64-174 and 64-175, 1964-1 (Part I) C.B. 183, 185; Rev. Rul. 65-271, 1965-2 C.B. 161; and Rev. Rul. 66-46, 1961-1 C.B. 133.) Such cultural organizations have most often been recognized as being organized and operated exclusively for "educational" purposes though they may also be characterized as "charitable" organizations since the term charitable in its generally accepted legal sense includes the advancement of education.

In Rev. Rul. 66-178, 1966-1 C.B. 178, the Service recognized as exempt under section 501(c)(3) of the Code a nonprofit organization that sponsored an annual public art exhibit that gratuitously displayed the works of unknown but promising artists. Although the organization charged a nominal admission fee to the exhibit and sold a catalogue describing the exhibit at a nominal fee, the organization did not sell or offer the displayed works for sale.

However, Rev. Rul. 66-178 is to be contrasted with Rev. Rul. 71-395, 1971-2 C.B. 228, which described a cooperative art gallery formed by a group of artists to exhibit and sell their works. Additional artists were admitted to membership in the gallery only on approval of the existing members. All works displayed at the gallery could be purchased by the public and many could be rented. The gallery retained a commission from the sales and rentals to cover its costs of operations, with any deficits being covered by special assessments of the members. In concluding that the described art gallery was not entitled to recognition of exempt status, Rev. Rul. 71-395 emphasized that the gallery was a vehicle for advancing the careers of its members and for promoting the sale of their works. As such, it "...serves the private purposes of its members, even though the exhibition and sale of paintings may be an educational activity in other respects." Accordingly, the organization

failed to qualify for exemption as it was deemed operated for the benefit of private individuals within the prohibition of section 1.501(c)(3)-1(d)(11) of the Regulations.

As in Rev. Rul. 71-395, the organization described in Rev. Rul. 76-152, 1976-1 C.B. 151, seeks to accomplish its stated purpose through the exhibition and sale of works of art. In both cases the work of the artist is sold by the gallery for the mutual benefit of the gallery and the individual artist. In contrast, the gallery described in Rev. Rul. 76-152 is not under the control of the artists whose works are exhibited but rather exhibits the works of an artist whose submission is selected for display. Nevertheless, Rev. Rul. 76-152 applied the rationale of Rev. Rul. 71-395 and held that a nonprofit organization formed by art patrons to promote community understanding of modern art trends by selecting for exhibit, exhibiting, and selling art works of local artists, retaining a commission on sales less than customary commercial charges and not sufficient to cover the costs of operating the gallery, does not qualify for exemption under section 501(c)(3) of the Code.

It is well established that a purpose or use is not charitable unless it is directed to the public benefit, so that the element of public benefit is a necessary condition of legal charity. (See Bogert, Trust and Trustees, sections 363 and 368 (2d ed. 1969); Scott, The Law of Trusts, section 368 (3d ed. 1967); and Restatement (Second) of Trusts, section 368, comment (b) (1959).) If the purposes or operations of an organization are such that private individuals who are not members of a charitable class receive other than an insubstantial or indirect economic benefit therefrom, such activities are deemed repugnant to the idea of an exclusively public charitable purpose. This result is the same, moreover, even if the purposes and activities of the organization would be charitable were it not for the element of private benefit.

Your organization is like the cooperative art gallery in Rev. Rul. 66-178, supra. You not only advance the arts by providing exposure and educational opportunities to promising artists and art education to the general public, but you also provide inurement of income to individual artists by serving their private purposes.

A prohibited direct economic benefit is conferred on the individual artists in the sales of art works. As noted above, when a sale is made your organization retains a small percentage of the purchase price as a commission with most of the sums collected being forwarded to the artist. Thus, the sale activity provides the artist with a direct monetary benefit and serves to enhance his artistic career. This benefit cannot be dismissed as being merely incidental to the organization's other exempt purposes and activities as it is substantial by any measure.

Although it is recognized that certain aspects of your organization's purposes and activities are in accord with traditional concepts of charity law in fostering and encouraging appreciation of art, it is incapable that the described sales confer a direct economic benefit on the particular artists. Cf. Rev. Rul. 66-104, 1966-1 C.B. 135. Accordingly, by balancing the public and private interests served by the organization's activities, we rule that such sales do not serve a public purpose.

The Supreme Court, in Batter Business Bureau v. United States, 326 U.S. 279 (1945), held that the presence of a single non exempt purpose will destroy exemption regardless of the number of truly exempt purposes.

Since more than an insubstantial part of your activities are not exclusively for exempt purposes you are not operated exclusively for purposes described in section 501(c)(3) of the Code and you do not qualify for tax exempt status.

Based on the information submitted, exempt status will not be recognized under any related paragraph of section 501(c).

Contributions to you are not deductible under section 170 of the Code.

In accordance with this determination you are required to file Federal income tax returns on Form 1120 for each year you have been in existence.

File these returns with this office within 60 days of the date of this letter. We will not delay processing of income tax returns and assessment of any taxes due because of your bringing suit for declaratory judgment under Code section 7428. File returns for later tax years with the appropriate service center indicated in the instructions for those returns.

If you do not accept our findings, we recommend that you request a conference with a member of our Regional Office of Appeals. Your request for a conference should include a written appeal giving the facts, law, and any other information to support your position as explained in the enclosed Publication 892. You will then be contacted to arrange a date for a conference. The conference may be held at the Regional Office, or if you request, at any mutually convenient District office. If we do not hear from you within 30 days of the date of this letter, this determination will become final and a copy of this letter will be sent to the appropriate state officials in accordance with section 6104(c) of the Internal Revenue Code.

If you do not protest this proposed determination in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Internal Revenue Code pro-

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vides in part that, "A declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the Court of Claims, or the district court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service."

Sincerely yours,

[REDACTED]
District Director

Enclosure

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